

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
ROBERT DeFILIPPIS CRANE SERVICE, INC.	:	DETERMINATION
AND ROBERT DeFILIPPIS	:	
AND MADELINE DeFILIPPIS,	:	DTA NO. 807042
AS OFFICERS	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period September 1, 1982	:	
through November 30, 1985.	:	

Petitioners, Robert DeFilippis Crane Service, Inc., and Robert DeFilippis and Madeline DeFilippis, as officers, 15-10 130th Street, College Point, New York 11356, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1982 through November 30, 1985.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 28, 1991 at 1:30 P.M. and continued at Riverfront Professional Tower, 500 Federal Street, Troy, New York, on January 16, 1992 at 9:15 A.M. and continued to conclusion at the same location on October 27, 1992 at 9:45 A.M., with all briefs to be submitted by March 10, 1993.

Petitioners appeared by Max Felberbaum, CPA, on March 28, 1991, David Fusco, CPA, on January 16, 1992 and James H. Tully, Jr., Esq., on October 27, 1992. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly used a test period audit method as a basis for determining the tax liability of Robert DeFilippisCrane Service, Inc. for the period September 1, 1982 through November 30, 1985.

II. Whether the Division of Taxation made a proper request for books and records.

III. Whether penalties and that portion of interest exceeding the minimum interest should be cancelled.

FINDINGS OF FACT

Petitioner Robert DeFilippis Crane Service, Inc. ("the corporation") was engaged in the rental of cranes and other construction equipment. Robert DeFilippis was president of the corporation and Madeline DeFilippis was the secretary.

On November 21, 1986, following an audit of the corporation's available books and records, the Division of Taxation ("Division") issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against the corporation covering the period September 1, 1982 through November 30, 1985 for taxes due of \$1,694,862.14, plus penalty and interest of \$967,442.82, for a total amount due of \$2,662,284.96. On the same date, a separate notice was issued to the corporation which assessed additional penalties of \$27,054.35 under Tax Law § 1145(a)(1)(vi) for omitting more than 25% of the sales tax found due in the quarterly periods beginning June 1, 1985.

Identical notices were issued to petitioners Robert DeFilippis and Madeline DeFilippis, as officers of the corporation, under Tax Law §§ 1131(1) and 1133.

On September 3, 1985, the Division mailed a letter to the corporation scheduling a field examination of its books and records for October 1, 1985. The letter indicated that the period under audit was "9/1/82-8/31/85".

The corporation was instructed to make available all books and records pertaining to its sales tax liability for the period under audit.

Accompanying the appointment letter was a listing of specific records requested to be available on the appointment date as follows:

"REQUIRED RECORDS FOR SALES TAX AUDIT

To Be Held On 10/1/85

Records for Audit Period 9/1/82 To 8/31/85
Includes the Following:

1. GENERAL LEDGER 9/82-8/85

2. CASH RECEIPTS JOURNAL 9/82-8/85
3. CASH DISBURSEMENT JOURNAL 9/82-8/85
4. FEDERAL INCOME TAX RETURNS FOR YEARS: Last 3 years 1982 & 1983 1984 on ext.
5. SALES TAX RETURNS AND CANCELLED CHECKS FOR QUARTERS ENDED 11/30/82-8/31/85
6. PURCHASE INVOICES FOR >
7. SALES INVOICES FOR: > To Be Determined
8. EXPENSE INVOICES FOR: >
9. ALL FIXED ASSET INVOICES FOR FIXED ASSETS ACQUIRED DURING AUDIT PERIOD
10. GUEST CHECKS AND REGISTER TAPES FOR:
11. RESALE, EXEMPT AND CAPITAL IMPROVEMENT CERTIFICATES SUPPORTING NON-TAXABLE SALES FOR: To Be Determined
12. OTHER: Sales Journal >
Purchase Journal > To Be Determined
Bank Statements >"

The audit actually commenced on November 6, 1985. During the course of the audit, the auditor orally requested the same records as in his original appointment letter for the period September 1, 1985 through November 30, 1985. In addition, the auditor left a handwritten document entitled "Records Required For Next Appointment". Included on the list were all sales invoices for equipment leased or rented for all of 1984 and any exemption certificates required to substantiate all nontaxable sales for 1984.

The corporation provided the auditor with sales tax returns, Federal and State income tax returns except for 1985, cash receipts journal, check disbursements journal, general ledger worksheet, bank statements and 41 sales invoices. Other records requested but not provided were sales journal, purchases journal, exemption certificates and any other sales invoices for the audit period.

The auditor examined the 41 sales invoices and found that sales tax was not charged on any of the invoices. The auditor also attempted to reconcile bank deposits for 1983 with the Federal corporation income tax return for that year, but such reconciliation revealed that the bank deposits exceeded gross sales by \$1,185,060.00. The corporation did not explain the discrepancy.

In the absence of any verifiable sales records, the auditor determined the corporation's

sales on the basis of bank deposits. The deposits totalled \$24,088,873.00¹ for the period September 1, 1982 through November 30, 1985. Sales taxes paid with returns filed for the period amounting to \$270,180.00 were deducted from the bank deposits to arrive at gross sales of \$23,818,693.00. The corporation had reported taxable sales of \$3,274,909.00, leaving unsubstantiated nontaxable sales of \$20,543,784.00. The corporation did not produce any exemption certificates for these sales which resulted in the auditor's assessing additional tax due of \$1,694,862.14.

The auditor imposed penalties because of the substantial underreporting and the lack of records maintained by the corporation.

The corporation was not able to provide many of the books and records required for the audit because they were in the possession of the U.S. Attorney's office as part of an investigation of New York City construction contractors. These records included sales invoices along with an exemption certificate, attached if applicable, and cash receipts records.

The corporation's representative, Max Felberbaum, indicated that he now had many of the records that were not available at the time of audit and requested time for the auditor and himself to examine the records for the purpose of a possible resolution of the case.

Mr. Felberbaum's request was granted with the agreement of the Division's representative.

The hearing was reconvened on January 16, 1992. Petitioners appeared by a new representative, David A. Fusco, CPA. During the time that elapsed between hearing dates, the Division's auditor met with Mr. Felberbaum on nine occasions. Mr. Felberbaum presented cash receipts reconstructions for 1983 and 1984, sales invoices for 1984 and a limited number of exemption certificates. Based on the auditor's review of the foregoing records, he made certain adjustments to the original audit. From the bank deposits, the auditor extracted additional deposits from non-business sources totalling \$793,922.00. Also, bank deposits were adjusted

¹The auditor allowed for any deposit determined to be a non-business receipt such as a loan or redeposited check.

for the sale of fixed assets amounting to \$1,986,165.00 which were examined in detail separately. The adjusted deposits, \$21,308,786.00, were applicable to receipts from equipment rentals including sales tax. The sales tax paid of \$270,180.00 was deducted, leaving gross equipment rentals of \$21,038,606.00.

Mr. Felberbaum and the auditor had agreed to utilize a test period for purposes of determining an allowance for nontaxable sales. Initially, it was agreed the test would encompass sales invoices and the cash receipts book for the year 1984. However, due to the volume of records and time limitations, it was mutually agreed to curtail the test period to March 1, 1984 through August 31, 1984. The corporation had exemption certificates to substantiate 11.25% of the claimed nontaxable sales.

The nontaxable percentage was applied to equipment rental bank deposits to determine taxable equipment rentals of \$18,671,762.00 with tax due thereon of \$1,540,420.38. This amount was combined with the tax due on the sale of fixed assets for a total revised tax liability of \$1,673,341.49. The sales tax paid of \$270,180.03 was deducted, leaving additional tax due of \$1,403,161.46.

The parties agreed to adjourn the hearing once again to review additional records in the possession of Mr. Fusco.

The hearing was reconvened on October 27, 1992. The corporation and Robert DeFilippis were now represented by James H. Tully, Jr., Esq., and Stewart Buxbaum, CPA, in addition to David Fusco from the previous hearing. The Division has agreed to cancel the notices issued to Madeline DeFilippis based on information obtained between hearing dates. Also, Robert DeFilippis agreed to his personal responsibility for any taxes due from the corporation.

During the interim period between hearing dates, David Fusco made additional records available to the auditor for review. The records included exemption certificates, documentation of non-sale deposits, deposits applicable to sales of assets and sales delivered to taxing jurisdictions with tax rates lower than 8¼%. Using the same procedures outlined in Finding of

Fact "7", the auditor revised the amount of tax due to \$1,029,935.95. The allowance for nontaxable sales for the test period increased to 22.79% based upon the additional exemption certificates. Mr. Fusco did not produce any additional sales invoices.

SUMMARY OF PETITIONERS' POSITION

Petitioners seek to have the sales tax liability reduced to \$369,546.01 by deleting the tax computed due on equipment rentals for all periods other than the year 1984 and tax due from the sale of fixed assets for the period September 1, 1985 through November 30, 1985. The recalculation utilized the nontaxable allowance determined by the auditor.

Petitioners maintained that the auditor's only serious request for books and records was for the year 1984. Petitioners argued that the appointment letter dated September 3, 1985 was a general request for "all records" but the attached sheet entitled "Required Records For Sales Tax Audit" was the specific request for records to be produced. Petitioners were not requested to produce purchase invoices, sales invoices, exemption certificates, sales journal, purchases journal or bank statements for any specific period which suggested to petitioners that the precise periods for these documents would be determined at a later time. Petitioners argued further that the only period for which sales invoices and exemption certificates were specifically requested was 1984 as indicated in the undated handwritten sheet entitled "Records Required For Next Appointment". Based on the foregoing, petitioners believe that the auditor did not make a proper request for rental invoices and documentation of nontaxable sales for 1982, 1983 and 1985 and therefore the Division's assessment for those periods was invalid. Additionally, petitioners argue that the appointment letter does not cover the period September 1, 1985 through November 30, 1985 and the auditor's oral request for that period is not documented in his files. Moreover, the power of attorney authorizing Max Felberbaum to represent petitioners did not cover periods after August 31, 1985.

With respect to the penalties, petitioners argued that the sales tax deficiency resulted from the wanton and willful misconduct of their former accountant, Max Felberbaum, in refusing to cooperate with the auditor and intentionally withholding records that would have

enabled the auditor to perform an actual audit without resort to an estimated method.

Petitioner Robert DeFilippis testified that Max Felberbaum was the corporation's accountant since 1964 and was relied upon to, among other duties, prepare sales tax returns and handle audits. Mr. DeFilippis went on to testify that the corporation had not been found to be deficient in a prior audit handled by Mr. Felberbaum and Mr. DeFilippis first became aware of the existing liability and hearing when he was notified by a lawyer that Mr. Felberbaum was in jail.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. The Division's authority to resort to external indices, however, is predicated upon a finding of insufficiency in the taxpayer's recordkeeping such that verification of sales is a virtual impossibility (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43). In such circumstances, the Division must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221), and the burden is on petitioners to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943, 512 NYS2d 542, 543).

B. To determine the adequacy of a taxpayer's records, the Division must first request and thereafter thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn.,

supra; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989). Where the Division follows such steps, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax.

C. The Division must make an actual request for the corporation's books and records that is more than "weak and casual" (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858).

In this case, the appointment letter was a clear and unequivocal request for all books and records for the period September 1, 1982 through August 31, 1985. The corporation produced many of the requested records for the audit period, i.e., bank statements and general ledger worksheets, indicating clearly that there was no confusion as to the period for which records were to be produced. The fact that the check list attached to the letter indicated sales invoices "to be determined" does not render such request inadequate (Matter of Scholastic Specialty Corp., Tax Appeals Tribunal, September 10, 1992).

The auditor made a specific oral request for the books and records for the period September 1, 1985 through November 30, 1985. The auditor's testimony in that regard is uncontroverted and further evidenced by the auditor's actual examination of the bank deposit records and records covering the sale of fixed assets for that period. The corporation did not produce any sales invoices or documentation on nontaxable sales until the first hearing date. The Division cooperated thoroughly with petitioners' representatives and agreed to examine all books and records presented and revise the liability accordingly. In sum, the corporation was on several occasions given adequate, meaningful opportunity to produce its books and records. The corporation's books and records provided on audit were clearly incomplete and insufficient. Accordingly, the audit methodology used by the Division, including a test period in determining an allowance for nontaxable sales, was reasonable.

D. Robert DeFilippis executed a power of attorney on November 18, 1985 authorizing Max Felberbaum to represent the corporation regarding sales and use tax for the period "8/1/82-8/31/85". Max Felberbaum represented the corporation in all aspects of the audit, appeared at a

conciliation conference on behalf of petitioners on August 24, 1988 and at a hearing with the Division of Tax Appeals on March 28, 1991. It was not until September 16, 1991 that Robert DeFilippis appointed David A. Fusco to represent the corporation relative to the sales tax audit and continued hearing. Prior to that time, Mr. DeFilippis in no way disclaimed or otherwise rejected Mr. Felberbaum's representation.

The purpose of any written power of attorney is not to define the authority of the agent, as between himself and his principal, but to evidence the authority of the agent to third parties with whom the agent deals (Keyes v. Metropolitan Trust Co. of City of New York, 220 NY 237, 115 NE 455). Despite the fact that the power of attorney did not include the period September 1, 1985 through November 30, 1985, it was sufficient to put the Division on notice of the extent of the authority of Max Felberbaum (see, Matter of Jenkins Covington NY, Tax Appeals Tribunal, November 21, 1991). Accordingly, it is concluded that the power of attorney was valid for the period September 1, 1985 through November 30, 1985 and the Division made a proper request for records covering that period from Max Felberbaum.²

E. Tax Law § 1145(a)(1)(i) provides for the imposition of penalty and interest for failure to file a return or pay over any tax when due. Subparagraph (vi) imposes an additional penalty of 10% if the omitted tax exceeds 25% of the actual tax due. Either penalty and that portion of the interest which exceeds the minimum amount prescribed under Tax Law § 1142 shall be waived if the taxpayer can establish that the failure or delay was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][iii], [vi]; 20 NYCRR 536.1[c]). The absence of willful neglect alone is not sufficient grounds for not imposing penalties and interest or for cancelling penalties and interest (20 NYCRR 536.5[a]). Petitioners'

excuse of reliance on the accountant does not constitute reasonable cause as construed by the

²If the power of attorney was invalid after August 31, 1985 as petitioners urge, then the petition signed by Max Felberbaum on February 12, 1987 to challenge the notices of determination issued November 21, 1986 is null and void and the Division of Tax Appeals has no jurisdiction over the matter.

governing regulation and the case law (see, 20 NYCRR 536.5[c]; see, Matter of Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557; Matter of LT & B Realty v. New York State Tax Commn., 141 AD2d 185, 535 NYS2d 121; Matter of Bachman v. State Tax Commn., 89 AD2d 679, 453 NYS2d 774, 776; Matter of Petrolane Northeast Gas Serv. v. State Tax Commn., 79 AD2d 1043, 435 NYS2d 187, lv denied 53 NY2d 601, 438 NYS2d 1027) in the absence of proof that the reliance was in good faith and was reasonable under the circumstances.

While petitioners stress that the underreporting of sales taxes was the result of Mr. Felberbaum's misconduct in refusing to cooperate with the auditor and withholding records that would have enabled the auditor to perform an actual audit, the evidence presented does not support such a conclusion. Accordingly, the penalties are sustained.

F. The petition of Robert DeFilippis Crane Service, Inc. and Robert DeFilippis, as officer, is granted to the extent that the additional taxes due are reduced to \$1,029,935.95. The Division is hereby directed to modify the notices of determination and demands for payment of sales and use taxes due issued November 21, 1986. The petition is in all other respects denied. The petition of Madeline DeFilippis is granted and the notices issued to her individually as officer of the corporation are cancelled.

DATED: Troy, New York
August 19, 1993

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE